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The relationship between corporate governance mechanisms and accounting measures of performance of the accepted companies in Tehran stock exchange

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Abstract

Relationship between corporate governance and company performance is an important topic in Accounting. Performance of an economic company depends on different factors. One of them is corporate governance which has a greet effect on performance. Our purpose is to study the relationship between corporate governance and accounting measures of performance of the accepted companies in Tehran stock exchange. In our study corporate governance is an independent variable and accounting measure of performance is a dependant variable. Considering limited samples, 109 companies accepted in Tehran Stock Exchange have been reviewed since 2006 to 2010 accounting to the ranking of the data. To test the hypothesis we have used the Spearman correlation coefficient for measurement of the impact of controlled variables on the relationship of independent chi-square test. Findings show that there is no meaningful relationship between percentage of independent directors of board and company performance while company performance has a meaningful relationship with institutional investors.

Keywords: Company performance, Corporate governance, Institutional investors, Percentage of independent directors of board

Introduction

Tension between rights of individual and organizations is one of the basic problems of our society. Nowadays financial markets and powerful stock companies grow greatly. Beside this growth, there should be legal tools till the companies can be responsible. The topic of company governance has been designed in this frame work. Corporate governance is a reaction to agency which rises from separation of ownership from management. Separation of ownership from management makes managers take decisions for the sake of their interests and against to interests of shareholders (Jensen & Meekling, 1976).

Indeed Corporate governance system is a set of rule, regulations, institute and policies that through different mechanisms determine how and for the benefit of whom companies manage. The purpose of Corporate governance is to be assured from existence of a framework that provides a good balance between manager's independence, accountability and benefits of shareholders (Hssas Yegane & Baghomiyan, 2005).

Institutional investor

Theoretically, the place of institutional investors in corporate governance is complicated. From this point of view, Institutional investors have strong corporate governance mechanisms which can be opened to view the company's management to monitor. They can also have considerable influence on company management and their interests are aligned with shareholders (Shleifer & Vishny, 1997).

Usually, institutional investors have power on company shares and become they are expert in investment, they have high ability to control companies (Velury, 2006). Del Guercio and D. Hawkins (1999) showed that supervised companies can limit and control managers behaviors. Supervision of institutional investors can encourage managers to pay more attention to company performance and have a little opportunism behaviors.

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Percentage of independent directors of board

The board of managers is the higher source of making decision in all small and big companies, that their decision does not affect the invest and wealth of the company. The board can elect or remove higher executive manager of organization. These managers do not conspire with executive manager because of their benefits since independent managers are generally executive managers in other companies they have a great motive to be famous. Because the motive of executive managers for using the wealth of owners for their benefits is not in a same direction with motive of independent managers to the famous, it improves the supervision on management and finally improves the performance of the company and decreases the cost of agencies (Fama, 1983), that is found as proportion of independent managers in the board to the total members of company board at the end of the year.

Company performance

By separation ownership from management and providing conflict between benefits, lack of assessment and control on company performance provide lack of better allocation of resources that makes some losses for shareholders and finally the economy losses. Defining and functionalizing company performance has been complicated and usually for doing it, different measures are used. In this study, for measuring company performance, we have used five indexes. They are rate of return on assets (Net profit divided by total assets), rate of return on equity (Net income divided by total equity), Ratio price to book value per share(P/B), Ratio price to earning per share(P/E) and Tobin's Q ratio.

Review of Related Literature

Shleifer and Vishny (1986) in their research showed that existence of big institutional investors because of increasing effective supervision has a positive effect on performance and value of the company. Maug (1998)in his research, concluded that the use of institutional investors of their ability for supervising on management and company performance depends on rate of their investment. Whatever the rate of institutional ownership increases, supervision on management improves, and it is a direct relationship.

Bushee's findings (1998) showed that institutional investors can improve the company performance, He believe that it is because of limitations that institutional investors provide against management motives. Chaganti and Damanpour (1991) in their research found that there is a positive relationship between institutional investors and rate of return on equity. Of course, Duggal and Millar (1999) in the united state of America studied the relationship between different kinds of institutional investors and company performance but that didn't find any relationship between institutional ownership and company performance.

Research by Colse and his colleagues (2003) showed that companies with more independent member in their board in Comparison to companies with more executive member in their board, have better performance. Also, Fama and Jensen (1983) found that the increase of independent member increases the efficiency of controlling the decisions and by increasing supervision through decreasing the Agency Costs, company performance will increase.

Although researchers found that there are some concepts that they don't have compatibility with Agency Theory. For example, Dalton and his colleagues by analyzing different research on performance of the board concluded that the rate of presence of independent managers in the board has no direct effect on performance of trade unit. Klien (1998) showed that there is no relationship between the rate of presence of independent managers with the level of performance of trade unit, but he saw that if there is a internal professional committee as audit committee and financing committee, will improve the performance of trade unit. Dehaene and his colleagues (2002) studied the relationship between company performance and the combination of the board in Belgium, and he did notfind any meaningful relationship. Fasberg(2005) also did not find any meaningful relationship between independent managers and different measures of performance.

Namazi and Kermani (2008) studied the effect of owner structure on accepted companies in Tehran stock exchange and found that there is a negative meaningful relationship between company performance and institutional investors (Namazi & Kermani, 2008). Kordlar (2005) showed that increasing institutional investors decreases the lack of information matching between managers and stockholders, can have a better supervision on company performance and manager and decrease the conflict of benefits (Nourvash & Ebrahimi, 2005). Finding of Nourvash and his colleagues

(2010) prove this issues, too. Rahman Seresht and Mazlumi (2005) found that institutional investors in stock companies decreases the agency costs and have a positive effect on their performance. Also the research by Hassas Yegane and his colleagues (2008) showed that the presence of institutional investors improves the company performance. Kordlar and his colleagues (2010) studied the effect of institutional ownership on the performance of accepted companies in Tehran stock Exchange and found that there is a positive meaningful relationship between institutional ownership and company performance. Modarres and his colleagues (2009), in their research, about studying the effect of institutional stockholders on return of stock holders, found that there isn't any meaningful relationship between institutional investors and company performance. Qalibaf Asl and Rezaie (2007), in their research about studying the effect of the combination of the board on the performance of the accepted companies in Tehran stock Exchange found that there is no meaningful relationship between the proportion of independent members of the board and company performance. Also, in a research by Hassas Yeganeh and his colleagues (2009) under the subject of studying relationship between quality of company governance and the performance, found no meaningful between independent managers in the board and company performance.

Research hypothesis

Hypothesis One: There is a Significant Relationship Between thepercentage of independent directors of board and company performance.

Hypothesis Two: There is a Significant Relationship Between the institutional investors and company performance.

Methodology

Population and data collection method

In this research the population included all the accepted companies in Tehran stock Exchange in industry and in other groups. Data were gathered from 2006 to 2010from 109 companies based on following limitations:

Companies should be in Tehran stock Exchange from 2006 to 2010.

End of financial year of each company is March 20.

They should not have any losses in recent years.

They should not have any changes in the activities and financial period.

Their data should be accessible.

They should not be a financial company for example banks or insurance company.

Gathering data was based on documents. We have used financial statements for doing this. we have used Tadbir software and website of Tehran stock Exchange.

Control variables

Size of company: As a measure for the size of company we have the sum of the assets of company at the end of the year for studying and calculating relationship between control variables and independent variables we have used Arithmetic mean of company in five years.

Financial leverage: it is by dividing total liability at the end of the financial period to shareholder's equity in the same financial year, then for studying relationship between control variables and dependent and independent variables we have used Arithmetic mean of Financial leverage of five years.

Data analysis method

Based on the purpose of this study, our method is functional and quasi-experimental. Based on ranking data, we have used spearman correlation coefficient and for measuring the effect of control variables on relations, we have used Chi-squaretest ofindependence.Independent variables are Arithmetic mean of variables in five years. After calculating variables, we have ranked the sample companies according to each variable. So, each sample has five ranks according to: return on assets(ROA), rate of return on equity(ROE), Q Tobin ratio, Ratio price to book value per share(P/B) and Ratio price to earning per share(P/E). Then, for calculating performance, index we used:

$$\text{Performance (PER)} = \frac{1}{ROAranking} + \frac{1}{ROE\ ranking} + \frac{1}{QTobin} + \frac{1}{P/Branking} + \frac{1}{P/Eranking} \quad (1)$$

For total functional ranking, we have ranked the numbers again. So, by using regression model and analyzing data by *SPSS* software 16th version we have analyzed our hypothesis.

$$PER_{it} = \beta_0 + \beta_1 Outdir_{it} + \beta_2 NATinvest_{it} + \beta_3 SIZE_{it} + \beta_4 LEV_{it} + \varepsilon_{it} \quad (2)$$

in which:

PER_{it}: performance of company i in period t

$Outdir_{it}$: percentage of independent directors of board of company i in period t

$NATinvest_{it}$: institutional investors of company i in period t

$SIZE_{it}$: Size of company i in period t

LEV_{it}: Financial leverage of company i in period t

ε_{it}: Error term for company i in period t

Results and Discussion

In correlation method, one of the assumption is that the distribution of variables in normal. For measuring the normality of variables, we have used Kolmogorov-Smirnov test the results are shown in table 1 below:

Table(1). The results of normality tests

Result	Sig	variable
Normal	0/166	Institutional investors
Normal	0/111	Percentage of independent directors of board
Normal	0/327	Rate of return on equity(ROE)
Normal	0/165	Return on assets(ROA)
Normal	0/093	Q Tobin ratio
Normal	0/103	Ratio price to earning per share(P/E)
Normal	0/078	Ratio price to book value per share(P/B)
Normal	0/089	Financial leverage
Normal	0/139	Size of company

Hypothesis One: There is a meaningful relationship between the presence of the independent directors in the board with company performance.

Performance is a dependant variable and ratio of independent directors in the board is independent variable. Hypothesis H_0 is lack of correlation between dependent and independent variables and Hypothesis H_1 mean there is a correlation between dependent and independent variables. Since the level of significance is (0/169) and it is bigger than accepted amount (0/05), we cannot reject H_0. So there is no meaningful correlation (%95) between independent directors in the board and company performance. So, the research showed that the role of independent directors do not match with agency theory. It means that it cannot remove the conflict between stockholders and directors. And, it is a weak supervisor tool in improving company performance. These findings are coordinate with finding by Dehaene and his colleagues (2002), Fasberg (2005), Qalibaf Asl and Rezaei (2007), Hassan Yegane and his colleagues(2009) and are inconsistent with Fama and Jensen (1983) and Coles(2003).

Hypothesis Two: There is a meaningful relationship between presence of institutional investors and improving company performance. Hypothesis H_0 means lack of correlation between the presence of institutional investors and company performance. Since the level of significance (0/039) is less than accepted level (%5), hypothesis H_0cannot be accepted and hypothesis $H_1$is confirmed. Then, there is a correlation between the presence of institutional investors and company performance. These findings are coordinate with findings of Chaganti and Damanpour (1991), Maug (1998), Shleifer and Vishny (1986), Bushee (1998), Del Guercio and Hawkins (1999), Nourvash and colleagues (2010), Rahman Seresh and Mazlumi (2005), Kordlar and colleagues (2010), Yeganeh and colleagues (2008) and these findings are inconsistent with findings of Duggal and Millar (1999), Modarres and colleagues (2009), Namazi and Kermani (2008).

Table2. Summary of findings

Statistical results	N	Sig.	Coefficient	Hypothesis
Rejecting hypothesis	92	0/169	0/236432	Primary Hypothesis
accepting hypothesis	92	0/039	0/315389	Second Hypothesis

For better explanation of the results, the relationship of indices of performance variables, i.e., return on assets(ROA), rate of return on equity(ROE), Q Tobin ratio, Ratio price to book value per share(P/B) and Ratio price to earning per share(P/E) with dependent variables were tested separately. Results (unreported) showed that only the return on assets and the rate of return on equity has a meaningful and direct relationship with the presence of institutional investors.

Further, by considering the size of company and financial leverage as control variables, relationship between dependent and independent variables were studied. Sample companies have been divided to three groups, large, medium and small according to their sizes and according to financial leverage the have been divided to three groups, high, medium and low, too. Indices of dependent and independent variables were divided to different groups. According to functional index, they were divided to big, medium and small and according to ratio of independent members to total members of the board ad the presence of institutional investors, they were divided to two groups: more than 50 percent and lesser than 50 percent. Then, we composed two tables for functional variables and dependant variables. And, by using chi-square test the independent of independent variables and dependent variable were tested based on the size of company and financial leverage. Results showed that hypothesis H_0 is not accepted only for the relationship between performance with ratio of independent members in the board to total members with the coefficient of 0/037 in medium companies.

Conclusions

The results of Primary hypothesis showed that there is no meaningful relationship between independent directors in the board as one of internal mechanism of company governance with company performance. Since one of the possible reasons for above results is a limited corporation of independent members in the board in company activities and low supervision on company performance, independent members should try to know better about their dies, place and role that they will do their Job effectively.

The results of the Second hypothesis showed that there is a positive and meaningful relationship between institutional investors as a external mechanism of company governance and performance indexes. Therefore, we can conclude that these investors are a good motive for improving company performance.

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